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TAGS: ECON EFIN ETRD LO
SUBJECT: THIRD QUARTER REVIEW OF THE SLOVAK ECONOMY

¶1. Summary. Slovak economic growth slowed slightly to 5.3 percent in the third quarter of 2004, but still outpaced its Central European neighbors. Higher investments and household consumption replaced exports as the main economic catalyst. Growth should remain strong with inflow of foreign direct investment (FDI) continuing to gain momentum and new auto makers boosting the supply capacity of the economy. In addition, rising wage forecasts and GOS spending plans should accelerate domestic demand and further fuel economic growth. End summary.

¶2. The Slovak GDP rose at a real annual rate of 5.3 percent in the third quarter of 2004, down moderately from the 5.5 percent and 5.4 percent growth of the second and first quarter. In real prices, the GDP equaled USD 11.3 billion, 8.8 percent higher than the third quarter of 2003. The Slovak economy outpaced all of its neighbors as the Czech Republic, Poland, and Hungary registered 3.6, 4.8, and 3.7 percent growth respectively. For the EU, GDP growth equaled 2.1 percent for the quarter.

¶3. Domestic demand, up 7.3 percent, has replaced exports as the largest driving force of the economy. This rise was fueled by a 3.7 percent jump in household consumption, a 2.9 percent boost in public spending, as well as a 16.9 percent leap in gross investments (NOTE: gross investment equals investment plus change in inventories). Much of this investment comes from the two auto factories now under construction and should intensify further as actual production begins in 2006. Government spending should also continue to rise as the GOS has budgeted a 77 percent increase in construction for 2005.

¶4. The higher household spending was stimulated by increased real wages, which rose 1.2 percent in the quarter. The average nominal monthly wage in Slovakia reached USD 510 during the same period, up 8.8 percent from 2003. Analysts highlighted that third quarter real productivity improved by 15.8 percent from 2003 with a 4.7 percent increase in labor costs for the same period, a clear sign of growing competitiveness of the Slovak economy.

¶5. Export growth in constant prices slowed to 5.1 percent in the third quarter, down from 16.4 percent in the second quarter of ¶2004. Economists cited a three week summer hiatus at Volkswagen, Slovakia's largest exporter, as the main reason for the drop. Poor economic performance in Germany, the largest importer of Slovak goods, and the EU in general, also contributed to the decrease (NOTE: In the first three quarters, around 85 percent of Slovakia's exports headed to the EU). Imports rose by 9.6 percent, down from 17 percent growth in the previous quarter. For the first time in two years, the net trade contribution to the Slovak economy was negative, reducing the GDP by 3.7 percentage points.

¶6. The Slovak Statistics Office stated that it expects the economy to expand by 5.5 percent in 2004, compared to the 5.4 percent market consensus. The OECD anticipates the Slovak GDP to increase by 4.9 percent this year, followed by 4.8 percent and 5.0 percent growth in 2005 and 2006. The central bank drafted its monetary program on the expectation of 4.9 percent growth in ¶2005. Many analysts believe that growth around 5 percent appears sustainable into the next decade.

¶7. Comment. Growth in real wages, projected between 3.5 and 5 percent in 2005, increasing government expenditures, plus the start of auto production by Kia, Peugeot, and Ford should continue to push household consumption higher and reduce unemployment. In addition, exports will likely return to higher rates of growth resulting in robust GDP growth for the next three years. Finally, FDI inflow should exceed current account deficits and reduce Slovakia's net external debt burden. End comment.

THAYER

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